

Industrial Distribution

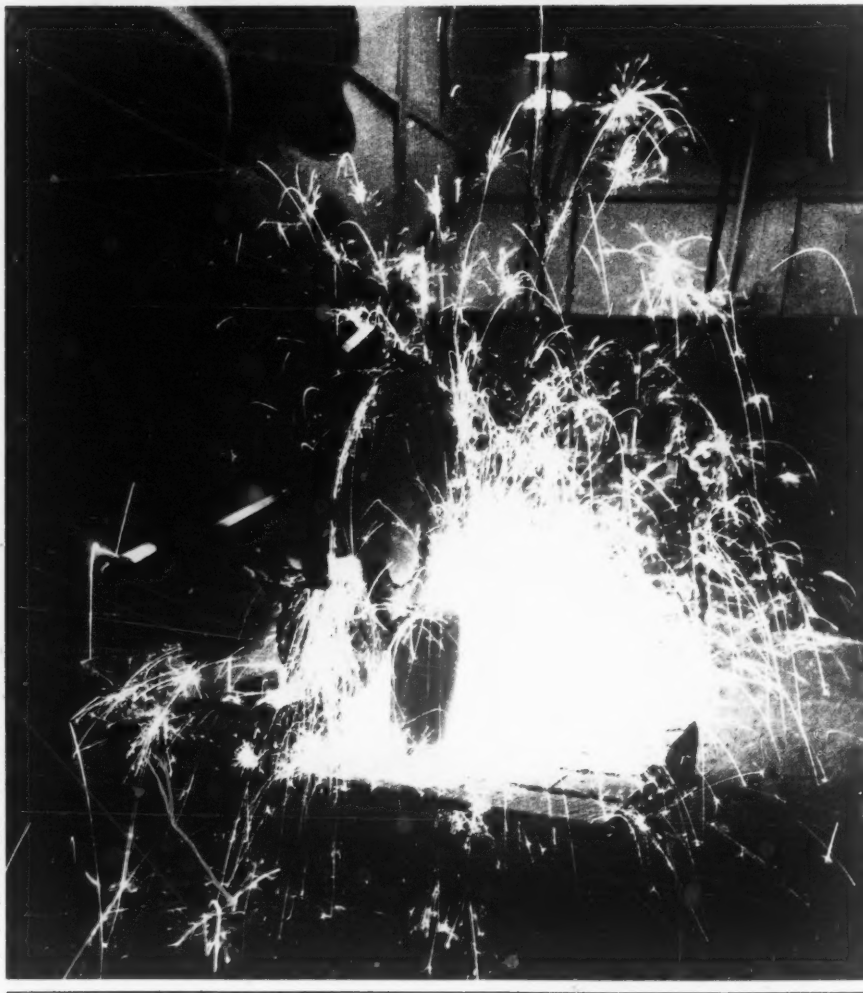


photo courtesy of Buckeye Abrasive, Inc.

SUPPLEMENT TO INDUSTRIAL DISTRIBUTION

Change and Opportunity

Distributors of cutting tools, abrasives and accessories can expect 1989 to resemble last year. For many, that is very good news. Yet for others, it means grappling with an industry dispensing change as quickly as it seems willing to provide new opportunities.

Most of this change will come in the form of increased sales spurred by new technologies. During 1988, INDUSTRIAL DISTRIBUTION estimates that U.S. manufacturers shipped \$3.8 billion worth of cutting tools, measuring tools, fluids, and other accessory items. This year, that figure could surpass the \$4 billion mark. On the abrasives side, 1988 shipments topped \$3 billion and are forecast to rise \$77 million this year to nearly \$3.2 billion (see chart).

At the heart of all this activity are new technologies that will continue to redefine the industry. In the industrial triangle of manufacturer, distributor and end user, all parties have been affected, with rising sales being the result of this evolution.

With the advent of CNC machines, cutting tools and abrasives manufacturers have had to scramble to get new products onto the market. And they must be capable of meeting, if not exceeding, the rigorous requirements of faster, more accurate cutting and forming machines. This situation is a complete reversal of the 1970s when machine tool producers were unable to keep pace with the arrival of new alloys and ceramic materials. In today's market, tools must be more reliable and predictable, because automation has meant that fewer operators will monitor production on the shop floor.

In turn, the end user seeks to increase productivity and quality

through factory automation. The recent trend in manufacturing has pulled away from flexible manufacturing systems, and moved toward highly versatile stand-alone machining centers, which are better suited to cellular systems manufacturing.

For the distributor, selling increasingly technical cutting tools and abrasives now presents exciting new possibilities. These products were once viewed as commodities (and many supply houses still sell them as such), but today the opportunity exists to market technical expertise, provide tool inspection as a value-added service, and build partnerships with customers who demand better tools, a wider variety of product, electronic order entry, and systems contracts.

Amid these technological changes, there have also been geographic shifts in the machine tool population. This is perhaps the most difficult and frustrating problem facing distributors. For the vast majority of supply houses, when a customer moves out of a given service area, perhaps from New England to the Carolinas, that customer is gone forever.

As in other industries, distributors of cutting tools and abrasives are feeling the effects of supplier terminations and the consolidation of smaller distributorships into branches of larger concerns. Also on the horizon is the reemergence of buying groups and their gravitation toward selling on price rather than performance and service.

The challenge for industrial distributors is to harness all this change. But unlike other industrial sectors, the market for cutting tools, abrasives and accessories is a growing rather than shrinking market. This is not an insignificant differ-

By John G.F. Bonnanzio
Associate Editor

ence. Further, as the rate of new product introductions accelerates, this difference will continue to transform the industry and bring to the distributor an abundance of strikingly new opportunities.

THE CHALLENGE

Sweeping changes have occurred in almost every aspect of the distributor's business, particularly in the area of cutting tools. A proliferation of new composites and tool geometries has resulted in greater choice for the end user, and has led to fewer manufacturers and vendors. According to one study, in 1977 almost 90% of cutting tools shipped were manufactured by 343 establishments. By 1982, competition reduced the supplier base to 315, without altering market share.

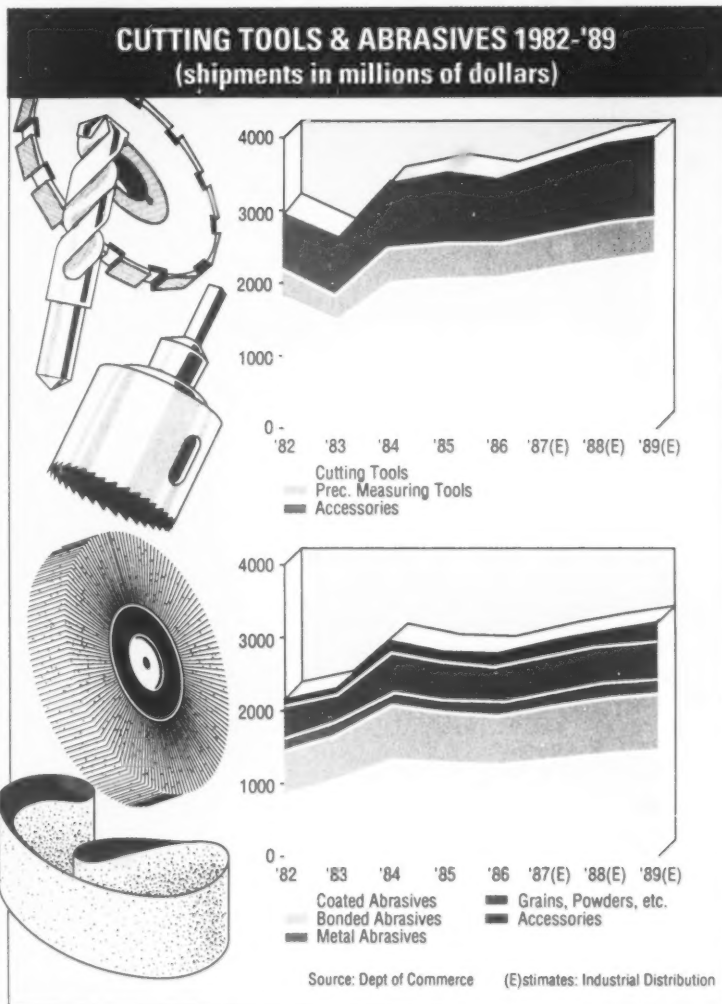
Such change was apparently evident during The Nat'l Machine Tool Builders exhibit held last year in Chicago. Reports David Sutliff, a capital goods analyst with Salomon Brothers Inc., "It looks like competition in the cutting tool businesses will intensify but probably will focus on technology and service, rather than price."

Sutliff also notes that companies such as Kennametal, Sandvik and GTE-Valenite have broadened their product lines and are now offering to solve customers' tool problems by "systematizing" their inventories. Such assistance in the tool crib would help maintain the proper level of tools, participate in product application, and also provide a foot in the door for specifying each company's own product.

For those manufacturers who continue to invest in the research and development of new product, the rewards appear promising. "We have seen a consolidation within the industry," explains American Securities' director of research, David Leibowitz. "The survivors will be the large, established, well-capitalized, and financially sound organizations."

One such player is Norton Co. Although weathering the effects of a recent restructuring program, the company has nonetheless invested 2% of its sales (\$90 million between 1985 and 1987) on research and development, with \$35 million earmarked for abrasives research alone. The result was the introduction of the seed-gel (SG) abrasive, which is widely regarded as an important breakthrough in bonded and coated product lines.

"Technology is an important part



II) estimates that shipments of cutting tool and abrasive products will increase 2½% this year. Total sales for 1989 in billions: Cutting tools, \$2.341; Precision measuring tools, \$534; Accessories, \$1.077; Coated abrasives, \$1.390; Bonded abrasives, \$.809; Metal abrasives, \$.230; Grains and powdered media, \$.504; Accessories, \$.210.

of the cutting tool industry," cautions Leibowitz. "This is an industry that has proved that each time there is a major advancement in technology, the product just jumps off the shelf."

Advances in the areas of materials, design and engineering, tool holders, cutting fluids, materials to be cut, tool life, ease of use, and the quality of the cut itself are all instrumental in altering the complexity of the business. In addition, each time a new product reaches the market, distributors have the opportunity to sell new customers and resell old ones.

"This is an expanding business," says Leibowitz, "it is also a business

ripe for new entrants." But for distributors who have linked their futures with manufacturers reluctant to or simply incapable of bringing new product to market, their security must certainly be somewhat less assured.

Distributors and manufacturers who carve for themselves specialty niches are likely to endure, if not prosper. Likewise, larger distributors who continue to work closely with their suppliers will also survive, so long as they're able to turn their inventory and squeeze acceptable margins.

Caught in the middle, suggest

industry observers, is the mid-size distributor struggling to be all things to all customers. Says Robert Campenella, a Cleveland-based distributor and president of U.S. Carbide Tool Inc., "The distributor who sells the commodity-type cutting tool is being squeezed. On one hand there are more big users buying direct, and with the specialty tools, they don't have the expertise or the right equipment to sell the higher-end products."

Lacking technical expertise, such a distributor will lose business to the

specialist with in-depth product knowledge, and might further suffer in his attempt to sell commodities based solely on price. In the meantime, however, as long as the industrial pie continues to grow, the mid-size distributor will have a fighting chance. But the economy's expansion can't last forever, and when it does finally retract, trouble is likely.

HOW STRONG IS THE MARKET?

There are many factors affecting the cutting tools, abrasives and accessories market. However, they are not

much different from those variables affecting other industries: military spending, capital spending on new plant and equipment, interest rates, new manufacturing methods and technologies, investment tax credits, depreciation, currency fluctuations, inflation, and foreign competition.

Happily, and perhaps surprisingly, the forecasts for many of these factors through 1989 are promising (see Market Outlook). But more important to the distributor than watching the prime rate is the outlook for the largest purchasers of cutting tools and abrasives. These are automobile and truck manufacturers, aerospace companies, farm and construction equipment manufacturers, nonelectrical machinery producers, steel warehouses, and oil and gas drillers.

While many economists see higher interest rates slowing gross national product to about 2½% in 1989, according to Thomas Burns of New York's prestigious investment bank Goldman, Sachs & Co., industrial production this year might still increase 4 to 5%. This would occur in the face of a sliding dollar resulting in growth in domestic exports. Regardless, most analysts don't foresee a recession in 1989, and new plant and equipment spending should increase a promising 6%.

THE VIEW FROM THE FIELD

Counting on yet another strong performance in basic industry is Robert Scanlon of The Cleveland Twist Drill Co. Noting that the market was "strong" all last year, the company's president credits increased production in aerospace, job shops and the automotive sector for Cleveland's healthy performance. "If anything we got hurt during the early '80s when everybody went to price as the only issue," recalls Scanlon. "Today," he says, "customers are discovering that the less expensive cutting tool is not necessarily the answer to their problems."

Across the country, there is much exuberance at the distributor level. "Capital spending has been up and business has been strong," says Thomas Bailey of Detroit's Bailey Saw and Machinery Co. A specialty distributor of bandsaw blades, Bailey has found the steel warehouse business (which accounts for roughly 25% of sales) "in good shape," along with tool and die shops, machinery manufacturers and the automakers.

To the surprise of many, Detroit closed its 1988 selling season with its third best year in history. And de-

[continued on pg. 15CT]

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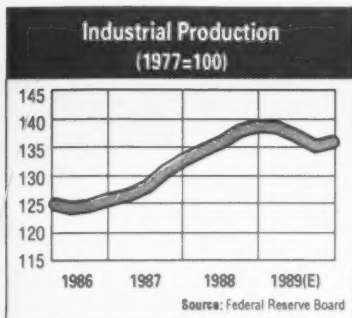


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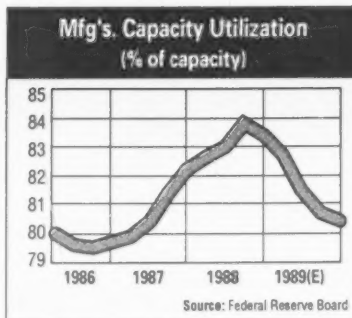
MARKET OUTLOOK

The Market Outlook for cutting tools and abrasives is predicated on the dollar rising through 1989. Expectations are for U.S. exports to increase at a slowing rate and, as a result, for industrial production to rise only slightly. With the election of George Bush as president, sustained military spending and changes in investment tax credits may keep industrial output as high as 5%, although many see 2% growth as realistic.

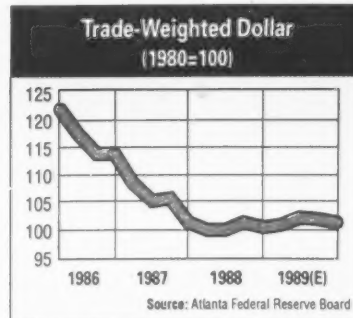
BAROMETERS



Despite marginal increases for '89, already high levels of production are a good sign for distributors.



As the year progresses, manufacturing's output could cool, but certainly not chill.



If the dollar begins to rise, exports could slow and commodity-grade imports could increase.

INDUSTRY FORECASTS

Domestic Auto Sales
(thousands of units)

Qtr:	1987	1988	1989(E)	1990(E)
1	1669	1914	1988	1918
2	1973	2076	2110	1951
3	1878	1787	1782	1703
4	1561	1658	1622	1622

Source: Motor Vehicle Mfgs. Assn

The year ahead could be another good one, as long as the dollar stays soft and the yen relatively high.

Aircraft & Parts Production
(1977 = 100)

Qtr:	1986	1987	1988	1989(E)
1	158.16	166.83	169.23	166.72
2	160.50	167.43	166.00	165.81
3	162.13	169.29	168.17	168.24
4	165.33	170.60	166.48	169.51

Source: Federal Reserve Board

Boeing and others intend to knock Airbus out of the skies by increasing productivity. Prospects look good.

Steel Service Centers
(1978 shipments = 70M tons/day)

Qtr:	1986	1987	1988	1989(E)
1	82,700	86,477	92,299	89,797
2	81,266	86,812	89,110	88,209
3	78,921	86,489	87,354	87,066
4	78,810	89,655	87,862	87,845

Source: Steel Service Center Institute

A 1% drop isn't bad when compared to 1986 and earlier. Besides, many see this drop as too pessimistic.

Nonelectrical Machinery Production
(1977 = 100)

Qtr:	1986	1987	1988	1989(E)
1	146.50	145.79	163.70	171.32
2	143.66	150.63	169.60	170.78
3	145.16	155.40	173.16	170.60
4	144.76	158.73	172.90	171.18

Source: Federal Reserve Board

Foreign demand for metalcutting machine tools increased 96% last year. A repeat in '89 is unlikely.

Construction, Mining, Farm Equipment Production
(1977 = 100)

Qtr:	1986	1987	1988	1989(E)
1	62.60	57.36	67.70	65.92
2	60.46	60.63	69.89	65.09
3	59.00	65.83	70.13	64.61
4	57.60	66.73	68.34	65.67

Source: Federal Reserve Board

Low-cost producing is key to competing globally. With retooling taking place, opportunities abound.

Oil & Gas Drilling Index
(1977 = 100)

Qtr:	1986	1987	1988(E)
1	113.36	67.23	86.10
2	68.40	69.86	86.63
3	60.40	88.03	82.66
4	66.73	90.86	84.66

Source: Federal Reserve Board

Rig counts inched up in '88 keeping some distributors busy. But sliding oil prices will continue.

(E) Estimates: Cahners Economics

spite Wall Street's crash late in '87, consumer confidence was unshaken while Americans gobbled up 15.6 million vehicles—an increase of 1%. The additional good news is that sales of imported cars and light trucks tumbled 7.5%, reflecting the weakening dollar against the yen.

This year, other industries promise the same kind of performance witnessed in 1988, although growth rates are not likely to be as spectacular (see p. 13). For example, while Cahners Economics forecasts a capacity utilization rate decline of 2% in 1989, those rates will still demonstrate remarkable strength at slightly above 81%—certainly nothing to sneer at.

Likewise, steel service centers will continue to cut iron at impressive speeds: 88,230 tons per day this year compared to 89,157 tons per day last year—a decline of only 1%. Says American Saw & Mfg.'s vice president of sales, Don Rooke, "That's a growing market. Activity is high and Lenox (the company's trade name) sells nothing but quality product. As

a result, we sold a lot of bandsaw blades."

One source of concern for Lenox, however, as well as for Bill Dowding who helps direct the company's marketing, is buying groups, which he says disrupt the manufacturer's ability to support a product. Claims Dowding, "They take the marketing strategy away from the supplier."

For example, while Lenox works with distributors to sell its saw blades as quality products well-deserving of a few additional dollars, buying groups pull a product toward commodity status. "Once you move your product away from being a commodity," says Rooke, "you can command a higher margin. Then we can earn some money and so can our distributors."

By choosing distributors who sell the company's reputation for quality, Lenox has grown its business. Such strategies have apparently worked in the North and South Carolina furniture markets. "There," says Dowding of his company, "we basically own that market with a share that would

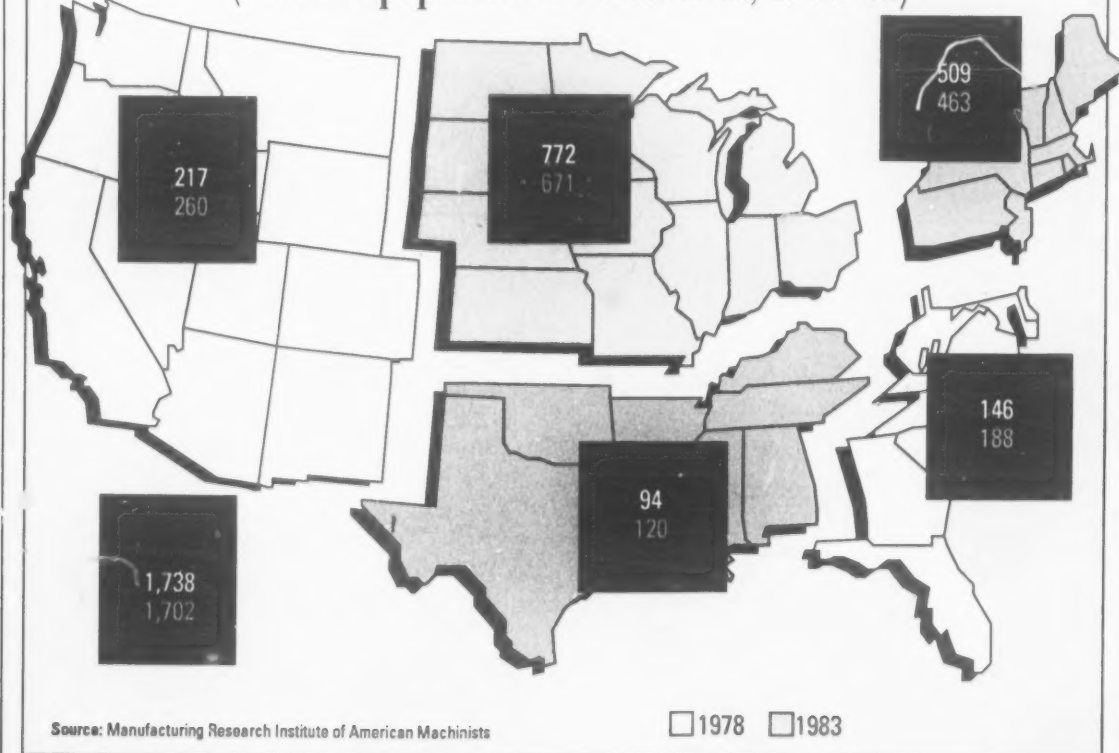
be unbelievable."

Vying for a piece of that southern pie is Jim Cornish of Iowa's Sioux Tools Inc. At Sioux, a manufacturer of air and electric power tools (as well as abrasive pads), Cornish finds the Carolinas, Florida, Georgia, and Tennessee all strong markets for his company's products. "There's a lot of boat building, cabinetry and furniture work going on right now," he says, noting that the International Woodworking Fair last year in Atlanta "was very, very successful."

Less successful, perhaps, are selling efforts directed at the nation's steel mills. Because of labor costs, most manufacturers are trying to eliminate as much finishing work as possible, particularly when cosmetic appearance and product performance are not diminished. But in other areas of industry, this is certainly not the case.

"Customers are demanding products with a finer finish," says 3M's division vice president, Richard McGrath. "Whether it's polishing a casket or smoothing bearings to

Metalcutting's Southward March (machine population in-thousands, 1978/'83)



within microscopic tolerances, competition demands that the overall quality of products be improved."

Although manufacturers are working to produce their products closer to near net shape, McGrath points out that the prospects for abrasives are still good. Better finishes are widely recognized as enhancing a product's operating life, particularly in products such as camshafts, where precision grinding is often required.

"For the most part," notes McGrath, "the manufacturing sector has had a very good year, and the distributor benefits directly from this increased productivity. If they continue to sell more abroad, distributors will sell more domestically." And how much does 3M guess that will be for 1989? "It's anybody's guess," McGrath says, then adds, "About 2½%."

THE MARKET SHIFTS

While few distributors would complain that industrial output is expanding, for many such good tidings have oftentimes appeared less promising. According to INDUSTRIAL DISTRIBUTION's 42nd Annual Survey of Distributor Operations, not all areas of the country are equally enjoying this new-found prosperity.

In fact, only distributors in the Northeast indicated a decline in sales for 1987. (Figures for 1988 are not yet available.) The region benefitting the most, however, was the Southeast. There, sales performance skyrocketed 33% in 1987 in sharp contrast to the national average of 5%, and the Northeast's dismal decline of nearly 4%.

One reason for this erosion is not difficult to determine. Beginning in the 1970s and continuing today, the machine tool population in the U.S. has been shifting steadily southward (see chart). While some think that this trend is greatly exaggerated, consider this: in 1987 the Nat'l Machine Tool Builders Assn. (now The Assn. for Manufacturing Technology) launched a new trade show. It wasn't held in Chicago, nor was it held in Cleveland, Buffalo or even New York City.

The exhibit was held in Charlotte, NC. Says the association, "The Southern Manufacturing Technology Show is designed to serve an area west to Memphis, north to Baltimore, and south to Tallahassee." Even without a great sense of geography, most know that Charlotte is quite a long way from Detroit, or even New Britain, CT, where Ernest Wardner is president of Smith &

Klebes, Inc., a specialty distributor of cutting tools and abrasives.

After noting that a few years back "the bottom fell out of the market," Wardner and his two partners have kept their business in the black by slashing back the company's overhead, getting a better handle on inventory control, and computerizing their entire operation.

In addition, Smith & Klebes had to identify who they could afford to conduct business with. "We're not all things to all people," says Wardner. "All our salespeople used to be manufacturing people, engineers and the like. This allows us to do the kind of specialized contracting that requires a tremendous level of expertise. That's how we make our money."

In New Britain, a suburb of Hartford in the Connecticut River Valley, the diversity of manufacturing that once dotted the landscape has been severely depleted in large part because of high labor costs. "We try to keep track of where the cutting machines move to," says Wardner. "Sometimes you can do it, and other times you find out that they're now in some place like Tennessee."

Down in Knoxville, Jim Slaple, Jr. understands Wardner's predicament but, of course, welcomes the new business. "It's kind of frustrating," says The Tool Crib's president. "Machine tools move from Milwaukee to Nashville and there isn't any way for that guy back there to maintain that business."

Describing last year's sales as "good," Slaple looks forward to increasing business at his three-branch distributorship through the support facilities supplying components for automakers now in the state. "We're just beginning to feel the effects of their presence in our area," he says, observing that once the lid is taken off a cookie jar, "it won't be long until you find some hands you'd rather not see in it, in it."

At National Twist Drill, a division of Regal-Beloit Corp., Frank (Skip) DeVilling calls Slaple's kind of approach to marketing "total procurement cost thinking." Says National's vice president of sales and marketing, "What we want are distributors who understand that price is only one factor, sometimes a very small factor, in selling a cutting tool. The classic strip-and-shop approach strips the distributor of the price of shipping, packaging, cost of possession, and availability. I can make anything in the world a special," says DeVilling, "if I'm the only guy that's got what you need." □

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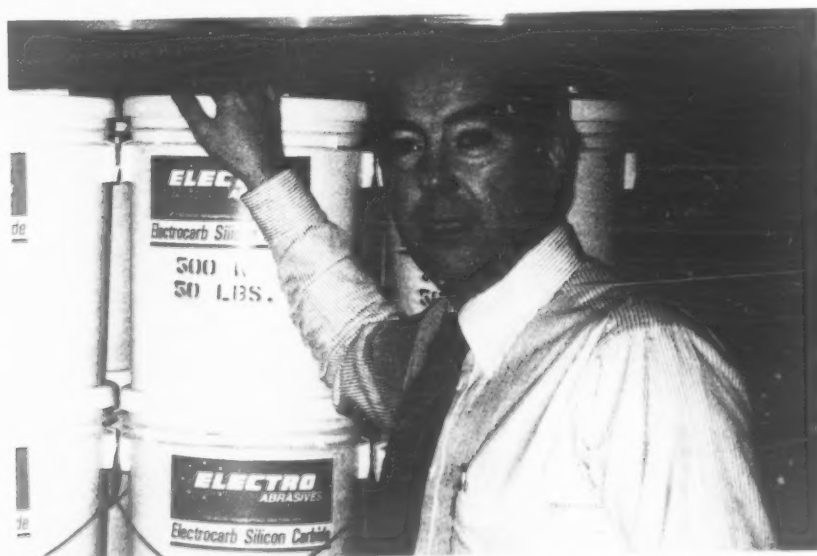
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The Forgotten Abrasive

Overlooked by most distributors as a potential profit maker, abrasive grains, one manufacturer exalts, is a \$500 million market.



Al Ramming's 3-year-old company ships abrasive grains at impressive speeds.

By John G.F. Bonnanzio
Associate Editor

Three years ago Al Ramming and five of his associates at Electro Abrasives made their bosses an offer they couldn't refuse. The company, then a subsidiary of Ferro Corp. in Buffalo, NY, was on the verge of divesting its abrasive grain division. With an uncertain future, Ramming and his colleagues formed a corporation, and ultimately bought the company.

The new management team, now in charge of its own fate, faced formidable challenges. One of the first obstacles was breaking a popular misconception among distributors

that "bulk media" was a small, and thus unprofitable, market. And there were other problems. In addition to the major steel manufacturers and refractories still in the throes of downsizing, many of Electro's largest customers were simply producing less. Meanwhile, near net size manufacturing techniques meant less call for finishing products, while slacking demand and overcapacity forced prices down.

But 1986 was a long time ago. Today, Electro is crushing crude silicon carbide at breakneck speeds. And although competing in a mature market, Electro's employees are working overtime to meet demand. "There are a number of reasons for

our success," explains the company's president. "Part of it is that we're employee owned, part of it is that we're competitive and ship quality products, and an important point is our philosophy to protect our distributors at all costs."

While Electro's determination to build trust with its distributors is admirable, it also makes good business sense. In an industry where a single specialty distributor often supplies the entire loose grain market for a given city, losing that supply channel can mean losing customers for years at a time. Therefore, Ramming makes certain that when quoting prices, every distributor gets the same deal to assure a

competitive footing.

In the rough-and-tumble loose grain market, that kind of price assurance is rare. And although most specialty abrasive distributors represent a single manufacturer, their allegiances are often determined by the supplier providing the best price and delivery, and not much more. On the manufacturers' side, some won't hesitate to take an account direct, doing little to assuage distributors' fears of being preempted on price.

"It's a very price-sensitive product," says Ramming, although he denies that abrasive grains can be de-

moted to commodity status because of increasingly rigid standards and critical applications. Notes Electro's plant manager Jim Kintzel, "It's not hard to imagine the effects of a #180 grit getting into a batch of #600 powder when polishing optical glass. You would have to throw the work away."

But higher quality standards have also opened new markets for the company, particularly in the area of electronics. A new generation of black silicon carbide grains is widely used in precision slicing and polishing of quartz crystals, silicon semicon-

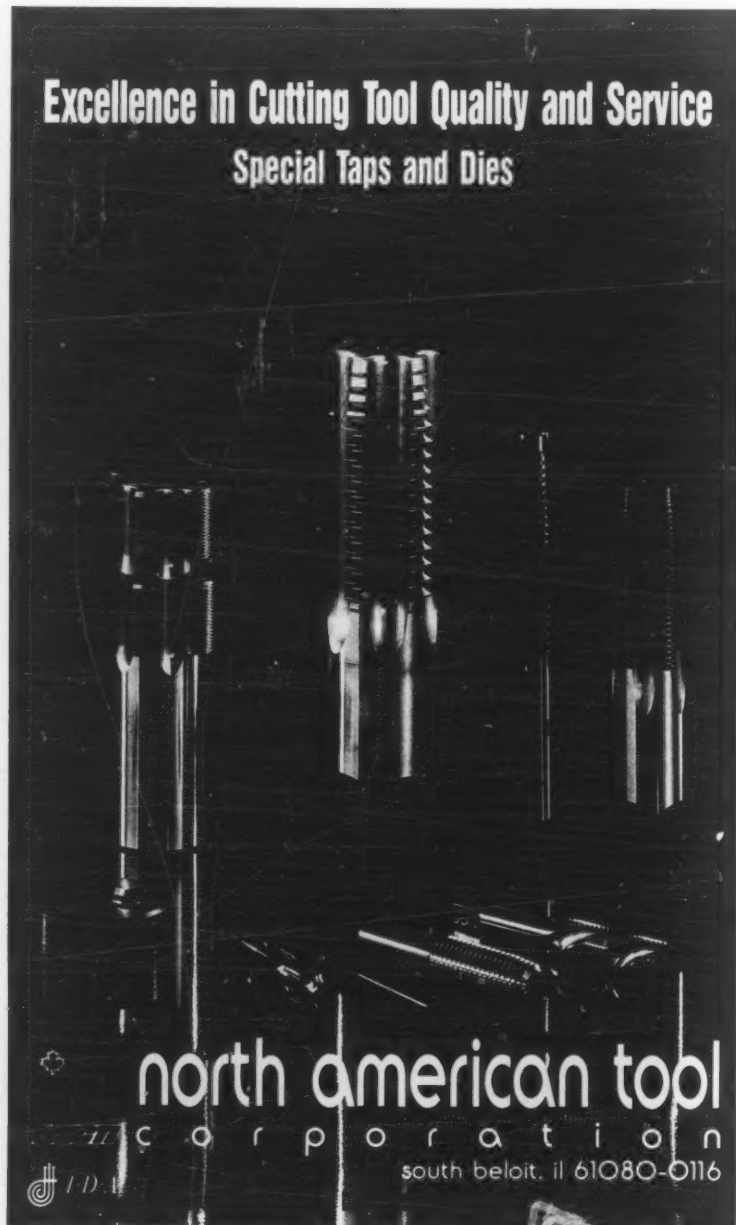
ductor wafers, and ferrites. And while many of the coarser grits are encountering difficult times in primary markets, such as metal fabrication shops, #600 to #1200 mesh silicon carbide and aluminum oxides are increasingly used as final polishes.

"The emphasis on finer finishes and particles has meant our moving less tonnage," says Ramming. "But now we've moved into more of a value-added niche by delivering a higher quality, refined product." Even so, distributors of loose grain abrasives still need to commit storage space because the product is obviously a bulky item.

To circumvent this problem, Electro drop-ships to its distributors' customers, and then, as Ramming puts it, "We close that confidential file until our distributors tell us to send some more product." From its location on the Niagara frontier, Electro says it can deliver within 24 hours to Michigan, Ohio, Pennsylvania, New Jersey, Massachusetts, Ontario and east to Long Island. For more distant

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Estimated Loose Grain Market (1985^(E) shipments in millions of \$)

Aluminum oxide	116
Silicone carbide	71
Steel shot/grit	66
Finished corundum	10
Tripoli	12
Slag	10
Garnet	7
Emery	1
Shells*	1
Diamonds	120
Glass bead	100
Total	514

*Includes walnut, peanut and almond

Sources: Bureau of Mines, Dept. of Commerce

(E)Estimates: Industrial Distribution

markets, Electro maintains warehouses in Texas and California, and is currently looking for additional distributors to fill some of its blanks.

As for the future, Ramming says that the company's outlook is bright. New metal matrix composites will require the increased use of silicon carbide and aluminum oxide powders in aluminum and magnesium castings. "When that starts to happen," explains Ramming calmly, "there's not enough powder capacity in the world to take care of these requirements. At that point," he says, "we will increase our capacity." □